WISCONSIN BUDGET PROJECT

Working Families to Pay Higher Taxes

Cut to Tax Credit Affects One Out of Four Wisconsin Children

Working families filing their state income tax returns this year may get an unpleasant surprise. That's because the Legislature made deep cuts to a tax credit that helps families with children get a leg up to the middle class. The result is that more than 140,000 working families in Wisconsin are getting less money back when they file their tax returns. More than one out of four Wisconsin children lives in a family that will be affected.

At the same time that lawmakers were raising taxes on working-class parents, they were giving tax breaks to the better-off. In the state's two-year budget, the Legislature cut $56 million from the state Earned Income Tax Credit (EITC), compared to the current policy. Over that same period, the Legislature approved tax cuts totaling $210 million that will primarily benefit businesses and upper-income taxpayers.

The cut in the EITC puts Wisconsin at odds with the national trend over the last two decades of reducing state income taxes on the working poor.

In the past, the state's EITC has received bipartisan political support as a tool to create jobs and reduce poverty. Wisconsin's refundable EITC was passed by a Democratic Legislature and signed into law by Republican Governor Tommy Thompson. A similar tax credit at the federal level has been supported by policymakers across the political spectrum.

Wisconsin's EITC benefits taxpayers who work, have children, and earn less than about $44,000 per year. The EITC was claimed on one out of ten tax returns in 2009, according to the Wisconsin Department of Revenue.

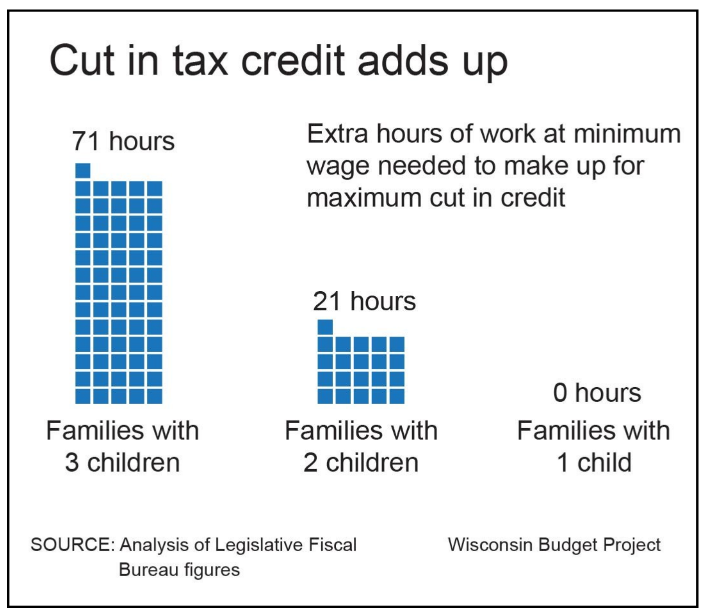
In 2012, Wisconsin is projected to invest $107.7 million in the state EITC, according to the Legislative Fiscal Bureau. About 60 percent of the money comes from the state's General Fund, and the remainder comes from money the federal government gives to the state to support low- and moderate-income families, through the Temporary Aid to Needy Families (TANF) program.

Reduced Purchasing Power Could Slow State's Economy

The state EITC helps strengthen low-income working families financially. These families typically spend the money quickly on necessities at local businesses, boosting the state economy and helping create jobs.

But the Legislature's cut to the EITC takes money out of the pockets of low-income parents who hold down jobs, and reduces their purchasing power. A single mother who has three children and works full-time at the minimum wage will have her tax credit reduced by $518 for tax year 2011, from $2,473 to $1,955. That is the equivalent of one and a half weeks of pay for a person working full-time at minimum wage.

For a family with two children, the credit will be reduced by up to $154, from $716 to $562. That adds



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2012

up to more than 20 hours of work at minimum wage. Families with only one child are not affected by the change to the credit.

Wisconsin's economy is not creating jobs very quickly. Reducing the purchasing power of working families by cutting the state's EITC could further slow the economy. In 2011, Wisconsin lost more jobs than any other state, according to the Bureau of Labor Statistics.

Working-Class Families Pay More in Tax than Higher Earners

The EITC reduces the amount of taxes that working families pay. By cutting the credit amounts, the Legislature has increased the amount of taxes these families pay.

The credit offsets state and local taxes paid by working-class families, including property taxes and sales taxes. If the amount of the credit earned by the family is greater than the family's income tax liability, the state sends a check to the family for the remaining credit amount.

Even taking the EITC into account, low-income families in Wisconsin pay a higher percentage of their income in state and local taxes than higher-income taxpayers. Families in the lowest income quintile in Wisconsin, earning less than $20,000 a year, paid 9.2 percent of their income in state and local taxes in 2009, according to the Institute on Taxation and Economic Policy. The top one percent of Wisconsin earners, who make $388,000 per year or more, paid just 8.0 percent of their income in taxes.

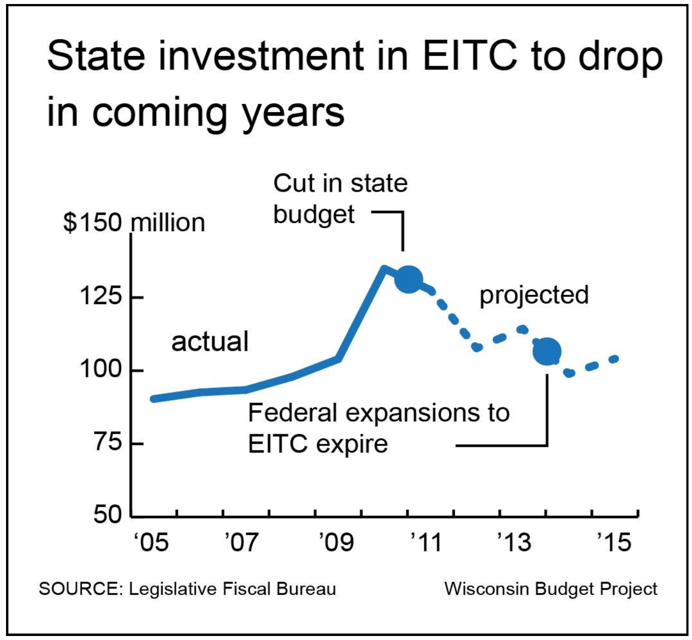
Credit Slated to Shrink Again

The EITC has played an important role in the nation's economic recovery after the recession. The Recovery Act of 2009 temporarily expanded the federal EITC with the goal of lifting additional families out of poverty, pumping money into the economy, and boosting job creation efforts. Because the state EITC is calculated as a percentage of the federal credit, Wisconsin's credit expanded at that time as well.

This increase in the federal — and by extension, the state — EITC is temporary, and is slated to last only through tax year 2012. At that point, working families in Wisconsin will see their state credit shrink again, unless Congress or the state Legislature act.

This means that working families in Wisconsin will see *two* significant decreases in their credit amounts: one due to the cuts made by the state Legislature that are already in effect, and another one that will occur when Recovery Act expansions expire.

By 2015, Wisconsin is projected to spend $28 million less on the EITC per year than it will in 2012, in inflation-adjusted dollars. That's a loss of more than one out of five dollars for tax relief for working-class families with children. The chart below shows the projected decline in state spending.



Conclusion

Many state policymakers are advocating for lower taxes, while at the same time increasing taxes for working-class families with children. Despite increases in the number of low-wage workers struggling to make ends meet, the Legislature has shrunk the amount of money available for tax credits for these families. This cut has the potential to further slow job creation in Wisconsin.

The Legislature should adjust the credit next session to prevent another drop in the state EITC when the Recovery Act expansion expires.

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April 2012